



Lesson Module 3:
Defensive Spending—Tackling Credit & Debit Cards



Module 3—Overview

Debit cards can be a very safe and convenient way to make purchases. But since money spent on a debit card comes right out of a bank account, heads up spending is essential.

Credit cards give you even more spending flexibility and convenience. But since credit cards don't come directly out of a bank account, you have to be careful you're not spending more than you can pay back.

As you learned in the previous lesson, interest can be a powerful tool in saving money. But interest can work against you if you're borrowing money on credit cards.

Defensive players always have to be alert. Otherwise, the offense can get away from them...and they'll be in big trouble. You've got to stay alert when dealing with your finances, or your spending can get away from you, too. And you'll be in even bigger trouble.

Goals

- Develop the knowledge and skills to use debit and credit cards properly, and understand the financial responsibilities involved

Objectives

- Determine the difference between credit and debit cards
- Understand how to shop for a credit card
- Read and interpret a credit card statement
- Understand the long-term results of the misuse of credit



Module 3—Teaching Notes

Credit cards come in three main types: bank card (like Visa); proprietary cards, for use at one particular store (like Sears); and travel and entertainment cards.

Advantages of using credit cards include:

- Ability to use item while paying for it
- No need to carry cash
- Use of card builds credit history
- Quick source of funds in an emergency
- No extra charge if bill is paid in full each month
- Consumer protection if card is lost or stolen

Disadvantages of using credit cards include:

- Must pay interest charges/card fees
- Need to establish credit worthiness before getting card
- Easy to allow bill to get too high

Finding the right credit card depends on knowing how you're going to use it. If you plan on using it for the convenience of not carrying cash, you're probably planning to pay it off in full each month. Because of that, the interest rate is not as important as avoiding an annual fee. If you plan on making a large purchase and paying it off over time, a card with a very low interest rate might be a better fit, even if it has an annual fee.

In picking the right card, you have to carefully examine all the costs and benefits:

- Annual Percentage Rate (APR)
- Grace period
- Annual fee
- Transaction fee
- Balancing computation method for finance charge
- Credit limit
- How widely card is accepted
- What services and features are available

Calculating finance charges is an essential part of understanding the full cost of using credit. The finance charge is the average daily balance multiplied by the daily percentage rate.



Unauthorized charges can occur, if someone steals a credit card or a credit card number. If you report the credit card missing before it is used, you aren't responsible for any of the fraudulent charges. Even if it is used before you report it, you're liable for no more than \$50.00. The bank that issued the credit card will take the appropriate legal action against the unauthorized user.

Protect yourself against fraud

- Always keep card with you or store in a safe place.
- When using card, watch person who is running charges (to be sure duplicate is not made).
- Never give card number over the phone if you did not initiate the call.
- Report lost or stolen cards immediately.
- Carefully read the bills before paying. Compare amount on receipts to amounts on bill. Don't always assume the bill is correct.
- Keep receipts; shred when not needed.
- Destroy unused credit card solicitations.

Debit cards look almost identical to credit cards. But there is one very important difference in how they function. While a credit card adds the money you spend to your outstanding balance, a debit card deducts your spending directly from your bank account. In short, debit cards are "pay now" and credit cards are "pay later."

The *advantages* of a debit card over a credit card include:

- Since you use your own money, debit cards are often easier to obtain.
- Spending doesn't add to your debt.

The *disadvantages* of a debit card compared to a credit card is:

- Chance of overdrawing from your account and paying penalty fees.
- If you don't have the money, you can't buy what you want.

Important facts about debit cards:

- There is no grace period for a debit card purchase. Since it's directly deducted from your checking account, make sure you have the money available to cover the full transaction amount at the time of sale.
- Some debit cards have monthly or per-transaction fees. Carefully review your cardholder agreement. Your issuer is legally required to disclose any fees you will be charged for card use.



Avoid problems with your debit card by following the these guidelines:

- Choose a PIN (personal identification number) that a smart thief couldn't figure out. Avoid obvious choices, such as your address, phone number, or birth date.
- Keep your PIN private. Memorize it. Don't write it down and never tell it to anyone.
- Know your current account balance. Don't forget about checks that have not yet cleared your account.
- Always take sales receipts and carbons. They may contain valuable information a thief could use to make mail, phone, or Internet purchases on your account.
- Record your transactions in your check register as soon as possible. Remember to include any debit card fees that may apply. Then store your receipts safely in one place in case you need them later.
- If your card is lost or stolen contact your card issuer immediately. This reduces your liability if fraud losses occur.

The most important aspect of credit card use to understand is the importance of paying your card balance off in full every month. Doing so avoids incurring interest and finance charges. While this is not always possible, it is almost always advisable.

Zero Liability is a guarantee that, if fraud charges occur on your debit card, you won't be held responsible. Although payment card fraud is rare, many of the card associations enhance federal security protections. Under federal regulations, consumers may be held liable for up to \$500 or more. If fraud is a concern, shop around for a debit card that offers you the best liability policy.



Module 3–Discussion

Credit cards can be extremely valuable financial tools. But they can also get you into trouble if you're not careful with them. Here are some guidelines on the wise use of credit.

Credit card do's and don'ts

Shop around

- Look at various sources

Read and understand the contract

- Read the contract carefully
- Don't rush into signing anything
- Once a contract is signed, get a copy of it
- Know the penalties for missed payments

Know your cost

- Figure out total price when paying with credit
- Make the largest payments possible
- Know the penalties for missed payments
- Buy on installment credit only after you have evaluated all other possibilities
- Don't be misled into thinking small payments will be easy



Module 3—Activity

Directions

Answer the following questions. You'll see for yourself how much items bought with credit can actually cost.

Questions

José wants to buy a stereo for \$650 and pay for it using a credit card that has an Annual Percentage Rate of 19.85% and a periodic interest rate of 1.65%. *Hint: Use the Credit Card Calculator on PracticalMoneySkills.com to help figure out the answers to the following questions.*

If José pays \$21.45 each month:

1. How long will it take him to pay for the stereo?
2. What is the total amount José will pay for the stereo?
3. What is José's total cost of using credit?

If José makes monthly payments of \$60:

4. How many months will it take for José to pay off the stereo?
5. What is the total amount José will pay for the stereo?
6. What is José's total cost of using credit?

Patty took a cash advance of \$1,500 on her credit card. Her new credit card, as a special promotion, charges an Annual Percentage Rate of 5.9% and a periodic interest rate of .4917% for the first six months. After the first six months, an Annual Percentage Rate of 21% and a periodic interest rate of 1.75% apply. The transaction fee for cash advances is 3% of the cash advance with a minimum fee of \$5.00 and a maximum fee of \$35.00. *Hint: Figure out the first six months. Then figure out the remaining balance and make your calculations from there. Don't forget to calculate the cash advance fee before you start, and add it to the total balance.*

If Patty makes monthly payments of \$60.50:

7. How long will it take Patty to pay for the cash advance?
8. What is the total amount Patty will end up paying for the cash advance?
9. How much interest and fees will Patty pay?

If Patty pays the cash advance back at a rate of \$120 per month:

10. How long will it take Patty to pay for the cash advance?
11. What is the total amount Patty will end up paying for the cash advance?
12. How much interest and fees will Patty pay?



Lesson Module 3 - Activity (continued)

Marie just used her new credit card to buy a bike for \$400. Her budget allows her to pay no more than \$25 each month on her credit card. Marie has decided not to use the credit card again until the bike is paid off. The credit card she used has an Annual Percentage Rate of 21% and a periodic interest rate of 1.75%.

If Marie pays \$25 each month on her credit card:

13. How long will it take Marie to pay for the bike?
14. What is the total amount Marie will end up paying for the bike?
15. How much interest will Marie pay for using her credit card to buy the bike?

If Marie pays the minimum payment of \$14 each month:

16. How long will it take Marie to pay for the bike?
17. What is the total amount Marie will end up paying for the bike?
18. How much interest will Marie pay for using her credit card to buy the bike?

Gary has just used his credit card to buy a new watch. He got the watch on sale for \$235. The regular price was \$290. He used a credit card that has an Annual Percentage Rate of 20% and a periodic interest rate of 1.67%.

If Gary makes the minimum monthly payment each month of \$10:

19. How much will Gary end up paying for his new watch?
20. How long will it take Gary to pay for his watch?
21. What is the total amount of interest Gary will end up paying?

If Gary pays \$25 each month, instead of the minimum monthly payment of \$10 each month:

22. How much will Gary end up paying for his new watch?
23. How long will it take Gary to pay for his watch?
24. What is the total amount of interest Gary will end up paying?